

HOUSE BILL NO.

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-FOURTH LEGISLATURE - SECOND SESSION

BY THE HOUSE RULES COMMITTEE BY REQUEST OF THE GOVERNOR

Introduced:

Referred:

A BILL

FOR AN ACT ENTITLED

1 **"An Act repealing the oil production tax and gas production tax and providing for a**
2 **production tax on the net value of oil and gas; relating to the relationship of the**
3 **production tax to other taxes; relating to the dates tax payments and surcharges are due**
4 **under AS 43.55; relating to interest on overpayments under AS 43.55; relating to the**
5 **treatment of oil and gas production tax in a producer's settlement with the royalty**
6 **owner; relating to flared gas, and to oil and gas used in the operation of a lease or**
7 **property, under AS 43.55; relating to the prevailing value of oil or gas under AS 43.55;**
8 **providing for tax credits against the tax due under AS 43.55 for certain expenditures,**
9 **losses, and surcharges; relating to statements or other information required to be filed**
10 **with or furnished to the Department of Revenue, and relating to the penalty for failure**
11 **to file certain reports, under AS 43.55; relating to the powers of the Department of**
12 **Revenue, and to the disclosure of certain information required to be furnished to the**

1 Department of Revenue, under AS 43.55; relating to criminal penalties for violating
 2 conditions governing access to and use of confidential information relating to the oil and
 3 gas production tax; relating to the deposit of money collected by the Department of
 4 Revenue under AS 43.55; relating to the calculation of the gross value at the point of
 5 production of oil or gas; relating to the determination of the net value of taxable oil and
 6 gas for purposes of a production tax on the net value of oil and gas; relating to the
 7 definitions of 'gas,' 'oil,' and certain other terms for purposes of AS 43.55; making
 8 conforming amendments; and providing for an effective date."

9 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

10 * **Section 1.** The uncodified law of the State of Alaska is amended by adding a new section
 11 to read:

12 INTENT OF SEC. 11 OF THIS ACT. It is the intent of the legislature through sec. 11
 13 of this Act to confirm by clarification the long-standing interpretation of AS 43.55.020(f) by
 14 the Department of Revenue.

15 * **Sec. 2.** AS 43.20.031(c) is amended to read:

16 (c) In computing the tax under this chapter, the taxpayer is not entitled to
 17 deduct any taxes based on or measured by net income. **The taxpayer may deduct the**
 18 **tax levied and paid under AS 43.55.**

19 * **Sec. 3.** AS 43.20.072(b) is amended to read:

20 (b) A taxpayer's business income to be apportioned under this section to the
 21 state shall be the federal taxable income of the taxpayer's consolidated business for the
 22 tax period, except that

23 (1) taxes based on or measured by net income that are deducted in the
 24 determination of the federal taxable income shall be added back; **the tax levied and**
 25 **paid under AS 43.55 may not be added back;**

26 (2) intangible drilling and development costs that are deducted as
 27 expenses under 26 U.S.C. 263(c) (Internal Revenue Code) in the determination of the
 28 federal taxable income shall be capitalized and depreciated as if the option to treat

1 them as expenses under 26 U.S.C. 263(c) (Internal Revenue Code) had not been
2 exercised;

3 (3) depletion deducted on the percentage depletion basis under 26
4 U.S.C. 613 (Internal Revenue Code) in the determination of the federal taxable income
5 shall be recomputed and deducted on the cost depletion basis under 26 U.S.C. 612
6 (Internal Revenue Code); and

7 (4) depreciation shall be computed on the basis of 26 U.S.C. 167
8 (Internal Revenue Code) as that section read on June 30, 1981.

9 * **Sec. 4.** AS 43.05.230(f) is amended to read:

10 (f) A wilful violation of the provisions of this section **or of a condition**
11 **imposed under AS 43.55.040(1)(B)** is punishable by a fine of not more than \$5,000,
12 or by imprisonment for not more than two years, or by both.

13 * **Sec. 5.** AS 43.55.011(a) is repealed and reenacted to read:

14 (a) There is levied upon the producer of oil or gas a tax for all oil and gas
15 produced each month from each lease or property in the state, less any oil and gas the
16 ownership or right to which is exempt from taxation. The tax is equal to 20 percent of
17 the net value of the taxable oil and gas as calculated under AS 43.55.160.

18 * **Sec. 6.** AS 43.55.017(a) is amended to read:

19 (a) Except as provided in this chapter, the taxes imposed by this chapter are in
20 place of all taxes now imposed by the state or any of its municipalities, and neither the
21 state nor a municipality may impose a tax upon

22 (1) producing oil or gas leases;

23 (2) oil or gas produced or extracted in the state;

24 (3) the value of intangible drilling and **development costs, as defined**
25 **in 26 U.S.C. 263(c) (Internal Revenue Code), as amended through January 1,**
26 **1974** [EXPLORATION EXPENSES].

27 * **Sec. 7.** AS 43.55.020(a) is repealed and reenacted to read:

28 (a) The production tax on oil and gas shall be paid as set out in this subsection.
29 Ninety percent of the tax levied under AS 43.55.011, net of any credits applied under
30 this chapter, is due on the last day of each calendar month on oil and gas produced
31 from each lease or property during the preceding month. The remaining portion of the

1 tax levied under AS 43.55.011, net of any credits applied under this chapter, is due on
 2 March 31 of the year following the calendar year during which the oil and gas were
 3 produced. An unpaid amount of tax that is not paid when due in accordance with this
 4 subsection becomes delinquent. An overpayment of tax with respect to a month may
 5 be applied against the tax due for any later month. Notwithstanding any contrary
 6 provision of AS 43.05.280, interest on an overpayment is allowed only from a date
 7 that is 90 days after the later of (1) the March 31 described in this subsection; or (2)
 8 the date that the statement required under AS 43.55.030(a) and 43.55.030(e) to be filed
 9 on or before that March 31 is filed. However, interest is not allowed if the
 10 overpayment was refunded within the 90-day period.

11 * **Sec. 8.** AS 43.55.020(b) is amended to read:

12 (b) The production tax on oil **and** [OR] gas shall be paid by or on behalf of the
 13 producer.

14 * **Sec. 9.** AS 43.55.020(d) is amended to read:

15 (d) In making settlement with the royalty owner **with respect to oil or gas**
 16 **that is taxable under AS 43.55.011**, the producer may deduct the amount of the tax
 17 paid on **taxable** royalty oil **and** [OR] gas, or may deduct **taxable** royalty oil or gas
 18 equivalent in value at the time the tax becomes due to the amount of the tax paid.
 19 **Unless otherwise agreed between the producer and the royalty owner, the**
 20 **amount of the tax paid on taxable royalty oil and gas for a month is deemed to be**
 21 **the product of the quantity of that taxable royalty oil and gas produced during**
 22 **the month times the quotient of the producer's total tax liability for the month of**
 23 **production under AS 43.55.011 divided by the producer's total quantity of**
 24 **taxable oil and gas, other than royalty oil and gas, produced from all leases and**
 25 **properties in the state during the month. For purposes of the product calculated**
 26 **under this subsection, 6,000 cubic feet of gas are considered to be equivalent in**
 27 **amount to one barrel of oil.**

28 * **Sec. 10.** AS 43.55.020(e) is repealed and reenacted to read:

29 (e) Gas flared, released, or allowed to escape in excess of the amount
 30 authorized by the Alaska Oil and Gas Conservation Commission is considered, for the
 31 purpose of AS 43.55.011 - 43.55.160, as gas produced from a lease or property. Oil or

gas used in the operation of a lease or property in the state in drilling for or producing oil or gas, or for repressuring, except to the extent determined by the Alaska Oil and Gas Conservation Commission to be waste, is not considered, for the purpose of AS 43.55.011 - 43.55.160, as oil or gas produced from a lease or property.

* **Sec. 11.** AS 43.55.020(f) is amended to read:

(f) If oil or gas is **not sold, or if oil or gas is** sold under circumstances where the sale price does not represent the prevailing value for oil or gas of like kind, character, or quality in the field or area from which the product is produced, the department may require the tax to be paid upon the basis of the value of oil or gas of the same kind, quality, and character prevailing during the calendar month of production for that field or area.

* **Sec. 12.** AS 43.55 is amended by adding a new section to read:

Sec. 43.55.024. Tax credits for certain losses and expenditures. (a)

Notwithstanding that a qualified capital expenditure may be a deductible lease expenditure for purposes of calculating the net value of oil and gas under AS 43.55.160(a), a producer or explorer that incurs a qualified capital expenditure may also elect to take a tax credit in the amount of 20 percent of that expenditure, unless a credit for that expenditure is taken under AS 43.55.025. A credit under this subsection may be applied only against a tax due under AS 43.55.011 - 43.55.160. Only for a calendar year for which the producer makes an election under AS 43.55.160(f), a producer that incurs a qualified capital expenditure during that year and that wishes to apply a credit based on that expenditure against a tax due under AS 43.55.011 - 43.55.160 shall calculate and apply every month an annualized tax credit in an amount equal to one and two-thirds percent of the total qualified capital expenditures incurred during that year and for which the tax credit is taken for that year, instead of taking a tax credit of 20 percent of each separate qualified capital expenditure after it has been incurred.

(b) A producer may elect to take a tax credit in the amount of 20 percent of a carried-forward annual loss. A credit under this subsection may be applied only against a tax due under AS 43.55.011 - 43.55.160. For purposes of this subsection, a carried-forward annual loss is the amount of a producer's adjusted lease expenditures

1 under AS 43.55.160 for a previous calendar year that was not deductible in any month
2 under AS 43.55.160(a) and (b).

3 (c) A credit under this section may not be used to reduce a person's tax
4 liability under AS 43.55.011- 43.55.160 for any month below zero; any portion of a
5 credit not used for that reason may be applied in a later month.

6 (d) A person entitled to take a tax credit under this section that wishes to
7 transfer the unused credit to another person may apply to the department for a
8 transferable tax credit certificate. An application under this subsection must be on a
9 form prescribed by the department and must include supporting information and
10 documentation that the department reasonably requires. The department shall either
11 grant or deny an application, or grant it as to a lesser amount than that claimed and
12 deny it as to the excess, no later than 60 days after the latest of (1) March 31 of the
13 year following the calendar year in which the qualified capital expenditure or carried-
14 forward annual loss for which the credit is claimed was incurred; (2) if the applicant is
15 required under AS 43.55.030(a) and 43.55.030(e) to file a statement on or before the
16 March 31 described in (1) of this subsection, the date the statement was filed; or (3)
17 the date the application was received by the department. If, based on the information
18 then available to it, the department is reasonably satisfied that the applicant is entitled
19 to a tax credit, the department shall issue the applicant a transferable tax credit
20 certificate for the amount of the credit. A certificate issued under this subsection does
21 not expire.

22 (e) A person to which a transferable tax credit certificate is issued under (d) of
23 this section may transfer the certificate to another person, and a transferee may further
24 transfer the certificate. Subject to the limitations set out in (a) - (c) of this section, and
25 notwithstanding any action the department may take with respect to the applicant
26 under (f) of this section, the owner of a certificate may apply the credit or a portion of
27 the credit shown on the certificate only against a tax due under AS 43.55.011 -
28 43.55.160. However, credits shown on transferable tax credit certificates may not be
29 applied so as to reduce a producer's total tax due under AS 43.55.011 - 43.55.160 on
30 oil and gas produced during a calendar year to less than 80 percent of the tax that
31 would otherwise be due without applying those credits. Any portion of a credit not

1 used for that reason may be applied in a later period.

2 (f) The issuance of a transferable tax credit certificate under (d) of this section
 3 does not limit the department's ability to later investigate or audit a tax credit claim to
 4 which the certificate relates or to adjust or deny the claim if the department determines
 5 that the applicant was not entitled to the amount of the credit for which the certificate
 6 was issued. The tax liability of the applicant under AS 43.55.011 - 43.55.160 is
 7 increased by the amount of the credit that is in excess of that to which the applicant
 8 was entitled. That amount bears interest under AS 43.05.225 from the date the
 9 transferable tax credit certificate was issued. For purposes of this subsection, an
 10 applicant that is an explorer is considered a producer subject to the tax levied under
 11 AS 43.55.011.

12 (g) The department may adopt regulations to carry out the purposes of this
 13 section, including prescribing reporting, record-keeping, and certification procedures
 14 and requirements for purposes of verifying the accuracy of credits claimed and
 15 ensuring that a credit is not used more than once, and otherwise implementing this
 16 section.

17 (h) For purposes of this section,

18 (1) "explorer" has the meaning given in AS 43.55.025(k);

19 (2) "qualified capital expenditure"

20 (A) means, except as otherwise provided under (B) of this
 21 paragraph, an expenditure that is a lease expenditure under AS 43.55.160 and
 22 is

23 (i) incurred for geological or geophysical exploration;

24 or

25 (ii) treated as a capitalized expenditure under 26 U.S.C.
 26 (Internal Revenue Code), as amended, regardless of elections made
 27 under 26 U.S.C. 263(c) (Internal Revenue Code), as amended, and
 28 either is treated as a capitalized expenditure by the person incurring the
 29 expenditure or is eligible to be deducted as an expense under 26 U.S.C.
 30 263(c) (Internal Revenue Code), as amended;

31 (B) does not include an expenditure to acquire an asset (i) the

cost of previously acquiring which was a lease expenditure under AS 43.55.160(c) or would have been a lease expenditure under AS 43.55.160(c) if it had been incurred on or after July 1, 2006; or (ii) that has previously been placed in service in the state; an expenditure to acquire an asset is not excluded under this subparagraph if no more than an immaterial portion of the asset meets a description under (i) or (ii) of this subparagraph; for purposes of this subparagraph, "asset" includes geological, geophysical, and well data and interpretations.

* **Sec. 13.** AS 43.55.030(a) is amended to read:

(a) The tax shall be paid to the department and the person paying the tax shall file with the department at the time the tax or a portion of the tax is required to be paid a statement, under oath, on forms prescribed by or acceptable to the department, giving with other information required, the following:

(1) a description of each [THE] lease or property from which the oil and [OR] gas were [WAS] produced, by name, legal description, lease number, or [BY] accounting codes [CODE NUMBERS] assigned by the department;

(2) the names of the producer and the person paying the tax;

(3) the gross amount of oil and the gross amount of [OR] gas produced from each [THE] lease or property, and the percentage of the gross amount of oil and of gas owned by each producer for whom the tax is paid;

(4) the gross [TOTAL] value at the point of production of the oil and of the [OR] gas produced from each [THE] lease or property owned by each producer for whom the tax is paid; [AND]

(5) the name of the first purchaser and the price received for the oil and for the [OR] gas, unless relieved from this requirement in whole or in part by the department; and

(6) the producer's lease expenditures and adjustments as calculated under AS 43.55.160 [IF SOLD IN THE STATE].

* **Sec. 14.** AS 43.55.030(d) is amended to read:

(d) Reports by or on behalf of the producer are delinquent the first day following the day the tax is due. [EACH PRODUCER IS SUBJECT TO A PENALTY

1 OF \$25 A DAY FOR EACH LEASE OR PROPERTY UPON WHICH THE
 2 REPORT IS NOT FILED. THE PENALTY FOR FAILURE TO FILE A REPORT IS
 3 IN ADDITION TO THE PENALTY FOR DELINQUENT TAXES, AND IS A LIEN
 4 AGAINST THE ASSETS OF THE PRODUCER.]

5 * **Sec. 15.** AS 43.55.030 is amended by adding a new subsection to read:

6 (e) In addition to other required information, the statement required to be filed
 7 on or before March 31 of a year must show any adjustments or corrections to the
 8 statements that were required under (a) of this section to be filed for the months of the
 9 preceding calendar year during which the oil or gas was produced.

10 * **Sec. 16.** AS 43.55.040 is amended to read:

11 **Sec. 43.55.040. Powers of Department of Revenue.** Except as provided in
 12 AS 43.05.405 - 43.05.499, the department may

13 (1) require a person engaged in production and the agent or employee
 14 of the person, and the purchaser of oil or gas, or the owner of a royalty interest in oil
 15 or gas to furnish, whether by the filing of regular statements or reports or
 16 otherwise, additional information that is considered by the department as necessary to
 17 compute the amount of the tax; notwithstanding any contrary provision of law, the
 18 disclosure of additional information under this paragraph to the producer
 19 obligated to pay the tax does not violate AS 40.25.100(a) or AS 43.05.230(a);
 20 before disclosing information under this paragraph that is otherwise required to
 21 be held confidential under AS 40.25.100(a) or AS 43.05.230(a), the department
 22 shall

23 (A) provide the person that furnished the information a
 24 reasonable opportunity to be heard regarding the proposed disclosure and
 25 the conditions to be imposed under (B) of this paragraph; and

26 (B) impose appropriate conditions limiting

27 (i) access to the information to those legal counsel,
 28 consultants, employees, officers, and agents of the producer who
 29 have a need to know that information for the purpose of
 30 determining or contesting the producer's tax obligation; and

31 (ii) the use of the information to use for that

purpose;

(2) examine the books, records, and files of [SUCH] a person
described in (1) of this section;

(3) conduct hearings and compel the attendance of witnesses and the
production of books, records, and papers of any person; and

(4) make an investigation or hold an inquiry that is considered
necessary to a disclosure of the facts as to

(A) the amount of production from any oil or gas location, or of
a company or other producer of oil or gas; and

(B) the rendition of the oil and gas for taxing purposes.

* **Sec. 17.** AS 43.55.080 is amended to read:

Sec. 43.55.080. Collection and deposit of revenue. **Except as otherwise
provided under art. IX, sec. 17, Constitution of the State of Alaska, the** [THE]
department shall deposit in the general fund the money collected by it under
AS 43.55.011 - 43.55.160 [AS 43.55.011 - 43.55.150].

* **Sec. 18.** AS 43.55.135 is amended to read:

Sec. 43.55.135. Measurement. For the purposes of **AS 43.55.011 - 43.55.160**
[AS 43.55.011 - 43.55.150], oil **is** [SHALL BE] measured in terms of a "barrel of oil"
and gas **is** [SHALL BE] measured in terms of a "cubic foot of gas."

* **Sec. 19.** AS 43.55.150(a) is amended to read:

(a) For the purposes of **AS 43.55.011 - 43.55.160** [AS 43.55.011 - 43.55.150],
the gross value **at the point of production is** [SHALL BE] calculated using the
reasonable costs of transportation of the oil or gas. The reasonable costs of
transportation **are** [SHALL BE] the actual costs, except **when the**

(1) [WHEN THE] parties to the transportation of oil or gas are
affiliated;

(2) [WHEN THE] contract for the transportation of oil or gas is not an
arm's length transaction or is not representative of the market value of that
transportation;

(3) [WHEN THE] method of transportation of oil or gas is not
reasonable in view of existing alternative methods of transportation.

1 * **Sec. 20.** AS 43.55.150 is amended by adding a new subsection to read:

2 (d) Under regulations adopted by the department, the department may allow a
3 producer, subject to limitations prescribed by the department as to the frequency of
4 making elections, to elect prospectively to calculate the gross value at the point of
5 production of oil or gas based in whole or part upon

6 (1) a royalty value determined under a royalty settlement agreement
7 between the producer and the state, with adjustments if appropriate;

8 (2) a formula prescribed by the department that uses, with adjustments
9 if appropriate, a royalty value or valuation methodology accepted by the

10 (A) Department of Natural Resources under AS 38.05, in the
11 case of oil and gas produced from a lease issued by the Department of Natural
12 Resources or produced from a lease or property that is part of a unit approved
13 by the Department of Natural Resources; or

14 (B) United States Department of the Interior under applicable
15 federal oil and gas leasing statutes, in the case of oil and gas produced from a
16 lease issued by the United States Department of the Interior that is not part of a
17 unit approved by the Department of Natural Resources, or produced from a
18 lease or property that is part of a unit approved by the United States
19 Department of the Interior but not approved by the Department of Natural
20 Resources; or

21 (3) another formula prescribed by the Department of Revenue that
22 reasonably estimates a value for the oil or gas at a specific geographical location such
23 as the point of tender or delivery into a common carrier pipeline; the formula may use
24 such factors as published price indices for oil or gas in or outside the state, quality
25 differentials for oil or gas, transportation costs between markets, and inflation
26 adjustments.

27 * **Sec. 21.** AS 43.55 is amended by adding a new section to article 1 to read:

28 **Sec. 43.55.160. Determination of net value of oil and gas.** (a) Except as
29 provided in (f) and (i) of this section, for purposes of AS 43.55.011, the net value of
30 the taxable oil and gas produced during a month is the total of the gross value at the
31 point of production of the oil and gas taxable under AS 43.55.011 and produced by the

1 producer from all leases or properties in the state, less (1) first, the producer's lease
2 expenditures for the month as adjusted under (e) of this section, and (2) second, to the
3 extent allowed under (g) of this section and until the total amount of the producer's
4 transitional investment expenditures has been deducted, an amount equal to 1/72 of the
5 producer's transitional investment expenditures. However, the net value calculated
6 under this subsection may not be less than zero.

7 (b) Any adjusted lease expenditures that would otherwise be deductible in a
8 month but whose deduction would cause the net value calculated under (a) of this
9 section of the taxable oil and gas produced during the month to be less than zero may
10 be added to the producer's adjusted lease expenditures for one or more other months in
11 the same calendar year. The total of any adjusted lease expenditures that are not
12 deductible in any month during a calendar year because their deduction would cause
13 the net value calculated under (a) of this section of the taxable oil and gas produced
14 during one or more months to be less than zero may be used to establish a carried-
15 forward annual loss under AS 43.55.024(b). An amount of transitional investment
16 expenditures that would otherwise be deductible in a month but whose deduction
17 would cause the net value calculated under (a) of this section of the taxable oil and gas
18 produced during the month to be less than zero

19 (1) may be deducted in a later month during any calendar year to the
20 extent allowed under (g) of this section, but no more than 1/72 of a producer's
21 transitional investment expenditures may be deducted in any month;

22 (2) may not be used to establish a carried-forward annual loss under
23 AS 43.55.024(b).

24 (c) For purposes of this section, a producer's lease expenditures for a period
25 are the total costs upstream of the point of production of oil and gas that are incurred
26 on or after July 1, 2006, by the producer during the period and that are direct,
27 ordinary, and necessary costs of exploring for, developing, or producing oil or gas
28 deposits located within the producer's leases or properties in the state or, in the case of
29 land in which the producer owns no working interest, direct, ordinary, and necessary
30 costs of exploring for oil or gas deposits located within other land in the state.
31 However, lease expenditures do not include the costs incurred to satisfy a work

1 commitment under an exploration license under AS 38.05.132. In determining whether
2 costs are direct, ordinary, and necessary costs of exploring for, developing, or
3 producing an oil or gas deposit located within a lease or property or other land in the
4 state, the department shall give substantial weight to (1) the typical industry practices
5 and standards in the state and in the United States as to costs that an operator is
6 allowed to bill a working interest owner that is not the operator, under unit operating
7 agreements or similar operating agreements that were in effect on or before
8 December 1, 2005, and were subject to negotiation with working interest owners, not
9 the operator, with substantial bargaining power; and (2) the standards adopted by the
10 Department of Natural Resources as to the costs, other than interest, that a lessee is
11 allowed to deduct from revenue in calculating net profits under a lease issued under
12 AS 38.05.180(f)(3)(B), (D), or (E). The Department of Revenue may authorize a
13 producer to treat as its lease expenditures under this section the costs paid by the
14 producer that are billed to the producer by an operator in accordance with the terms of
15 a unit operating agreement or similar operating agreement, if the Department of
16 Revenue finds that the pertinent provisions of the operating agreement are
17 substantially consistent with the Department of Revenue's determinations and
18 standards otherwise applicable under this subsection and that at least one working
19 interest owner party to the agreement, other than the operator, has substantial incentive
20 and ability to effectively audit billings under the agreement.

21 (d) For purposes of (c) of this section, direct costs

22 (1) include

23 (A) outlays for capital assets;

24 (B) payments in lieu of property taxes;

25 (C) a reasonable allowance, as determined under regulations
26 adopted by the department, for overhead expenses directly related to exploring
27 for, developing, and producing oil or gas deposits located within leases or
28 properties or other land in the state;

29 (2) do not include

30 (A) depreciation or amortization of capital assets;

31 (B) royalty payments;

(C) taxes based on or measured by net income;

(D) interest or other financing charges or costs of raising equity or debt capital;

(E) acquisition costs for a lease or property or exploration license;

(F) costs arising from fraud, wilful misconduct, or negligence;

(G) fines or penalties imposed by law;

(H) costs of arbitration, litigation, or other dispute resolution activities that involve the state or concern the rights or obligations among owners of interests in, or rights to production from, one or more leases or properties or a unit;

(I) donations;

(J) costs incurred in organizing a partnership, joint venture, or other business entity or arrangement;

(K) amounts paid for purposes of indemnification.

(e) A producer's lease expenditures must be adjusted by subtracting any payment or credit the producer receives

(1) for the use by another person of a production facility in which the producer has an ownership interest;

(2) for a reimbursement or similar payment that offsets the producer's lease expenditures, including any payment from the state or federal government for reimbursement of the producer's upstream costs, including any costs for gathering, separating, cleaning, dehydration, compressing, or other field handling costs associated with the production of oil or gas upstream of the point of production;

(3) for the sale or other transfer of

(A) an asset, including geological, geophysical, or well data or interpretations, acquired by the producer as a result of a lease expenditure or an expenditure that would be a lease expenditure if it were incurred on or after July 1, 2006; and

(B) oil or gas

(i) that is not considered produced from a lease or

1 property under AS 43.55.020(e); and

2 (ii) the cost of acquiring which is a lease expenditure
3 incurred by the person that acquires the oil or gas.

4 (f) In place of the adjusted lease expenditures for a month under (a) of this
5 section, a producer may at any time elect to substitute for every month of a calendar
6 year one-twelfth of the producer's adjusted lease expenditures for the calendar year.

7 (g) For the purposes of this section, a producer's transitional investment
8 expenditures are (1) the sum of the expenditures the producer incurred on or after
9 July 1, 2001, and before July 1, 2006, that would be qualified capital expenditures, as
10 defined in AS 43.55.024(h), if they were incurred on or after July 1, 2006, less (2) the
11 sum of the payments or credits the producer received before July 1, 2006, for the sale
12 or other transfer of assets, including geological, geophysical, or well data or
13 interpretations, acquired by the producer as a result of expenditures the producer
14 incurred on or after July 1, 2001, and before July 1, 2006, that would be qualified
15 capital expenditures, as defined in AS 43.55.024(h), if they were incurred on or after
16 July 1, 2006. An amount of transitional investment expenditures may not be deducted
17 under (a) of this section for a month for which the average price of Alaska North
18 Slope oil delivered on the United States West Coast, as determined under (h) of this
19 section, is equal to or less than \$40 per barrel, as adjusted for inflation under (h) of this
20 section.

21 (h) The average price described in (g) of this section shall be an average, as
22 calculated using a formula prescribed by the department by regulation, of published
23 daily spot price assessments during the month for Alaska North Slope oil delivered on
24 the United States West Coast. However, if the department determines that such daily
25 assessments cease or appear likely to soon cease to be published throughout the
26 calendar year or that they cease or appear likely to soon cease to be reliable evidence
27 of market conditions, the department shall by regulation provide that the average price
28 described in (g) of this section is the prevailing value of Alaska North Slope oil
29 delivered on the United States West Coast as determined under regulations of the
30 department implementing AS 43.55.020(f). For each year after 2006, the reference
31 price of \$40 per barrel set out in (g) of this section shall be adjusted for inflation using

1 an appropriate consumer price index published by the United States Bureau of Labor
2 Statistics, as prescribed by the department by regulation.

3 (i) For a month for which the net value of the taxable oil and gas produced
4 during the month calculated under (a) of this section exceeds zero, a producer that is
5 qualified under (j) of this section may reduce the net value by deducting an allowance
6 in an amount calculated such that (1) the net value for the month is not reduced below
7 zero; and (2) the total of the allowances deducted for all months during the calendar
8 year does not exceed \$73,000,000. An unused allowance or portion of an allowance
9 under this subsection may not be carried forward to a later calendar year or used to
10 establish a carried-forward annual loss under AS 43.55.024(b).

11 (j) Upon written application by a producer, including any information the
12 department may require, the department shall determine whether the producer
13 qualifies under this subsection for a calendar year. To qualify under this subsection, a
14 producer must demonstrate that its operation in the state or its ownership of an interest
15 in a lease or property in the state as a distinct producer entity would not result in the
16 division among multiple producer entities of any net value of taxable oil and gas, as
17 defined under (a) of this section, that would be reasonably expected to be attributed to
18 a single producer entity if the allowance provision of (i) of this section did not exist.

19 (k) If a cost that would otherwise constitute a lease expenditure under (c) of
20 this section is incurred to explore for, develop, or produce (1) both an oil or gas
21 deposit located within land outside the state and an oil or gas deposit located within a
22 lease or property, or other land, in the state, or (2) an oil or gas deposit located partly
23 within land outside the state and partly within a lease or property, or other land, in the
24 state, the department shall specify or approve a reasonable allocation method for
25 determining the portion of the cost that is appropriately treated as a lease expenditure
26 under (c) of this section.

27 (l) The department may adopt regulations that establish additional standards
28 necessary to carrying out the purposes of this section.

29 (m) For purposes of AS 43.55.024(a) and (b) and only as to expenditures
30 incurred to explore for an oil or gas deposit located within land in which an explorer,
31 as defined in AS 43.55.025(k), owns no working interest, the term "producer" in (c)

1 and (e) of this section includes "explorer."

2 (n) For purposes of this section,

3 (1) "explore" includes to conduct geological or geophysical
4 exploration;

5 (2) the drilling of a stratigraphic test well is considered geological
6 exploration for an oil or gas deposit located within land in the state only if the well's
7 target zones are located in the state; for purposes of this paragraph, a stratigraphic test
8 well is a well drilled for the sole purpose of obtaining geological information to aid in
9 exploring for an oil or gas deposit.

10 * **Sec. 22.** AS 43.55.201(b) is amended to read:

11 (b) The surcharge imposed by (a) of this section is in addition to and shall be
12 paid in the same manner as the tax imposed by AS 43.55.011, except that
13 notwithstanding anything to the contrary in AS 43.55.020(a), the full amount of
14 the surcharge is due on the last day of each calendar month on oil produced from
15 each lease or property during the preceding month. The surcharge [AS 43.55.011
16 - 43.55.150; AND] is in addition to the surcharge imposed by AS 43.55.300 -
17 43.55.310.

18 * **Sec. 23.** AS 43.55.201(c) is amended to read:

19 (c) A producer of oil shall make reports of production in the same manner and
20 under the same penalties as required under AS 43.55.011 - 43.55.160 [AS 43.55.011 -
21 43.55.150].

22 * **Sec. 24.** AS 43.55.201 is amended by adding a new subsection to read:

23 (d) Oil not considered under AS 43.55.020(e) to be produced from a lease or
24 property is not considered to be produced from a lease or property for purposes of this
25 section.

26 * **Sec. 25.** AS 43.55 is amended by adding a new section to read:

27 **Sec. 43.55.205. Tax credit for surcharge payment.** The amount of a
28 surcharge paid by a producer under AS 43.55.201 may be applied as a credit against
29 the producer's taxes due under AS 43.55.011 - 43.55.160. A credit under this section
30 may not be used to reduce a person's tax liability under AS 43.55.011 - 43.55.160 for
31 any month below zero; any portion of a credit not used for that reason may be applied

1 in a later month.

2 * **Sec. 26.** AS 43.55.300(b) is amended to read:

3 (b) The surcharge imposed by (a) of this section is in addition to and shall be
 4 paid in the same manner as the tax imposed by AS 43.55.011, except that
 5 notwithstanding anything to the contrary in AS 43.55.020(a), the full amount of
 6 the surcharge is due on the last day of each calendar month on oil produced from
 7 each lease or property during the preceding month. The surcharge [AS 43.55.011
 8 - 43.55.150; AND] is in addition to the surcharge imposed by AS 43.55.201 -
 9 43.55.231.

10 * **Sec. 27.** AS 43.55.300(c) is amended to read:

11 (c) A producer of oil shall make reports of production in the same manner and
 12 under the same penalties as required under AS 43.55.011 - 43.55.160 [AS 43.55.011 -
 13 43.55.150].

14 * **Sec. 28.** AS 43.55.300 is amended by adding a new subsection to read:

15 (d) Oil not considered under AS 43.55.020(e) to be produced from a lease or
 16 property is not considered to be produced from a lease or property for purposes of this
 17 section.

18 * **Sec. 29.** AS 43.55 is amended by adding a new section to read:

19 **Sec. 43.55.305. Tax credit for surcharge payment.** The amount of a
 20 surcharge paid by a producer under AS 43.55.300 may be applied as a credit against
 21 the producer's taxes due under AS 43.55.011 - 43.55.160. A credit under this section
 22 may not be used to reduce a person's tax liability under AS 43.55.011 - 43.55.160 for
 23 any month below zero; any portion of a credit not used for that reason may be applied
 24 in a later month.

25 * **Sec. 30.** AS 43.55.900(6) is repealed and reenacted to read:

26 (6) "gas" means

27 (A) all natural, associated, or casinghead gas;

28 (B) all hydrocarbons that

29 (i) are recovered by mechanical separation of well
 30 fluids or by gas processing; and

31 (ii) exist in a gaseous phase at the completion of

1 mechanical separation and any gas processing; and

2 (C) all other hydrocarbons produced from a well not defined as
3 oil;

4 * **Sec. 31.** AS 43.55.900(7) is repealed and reenacted to read:

5 (7) "gross value at the point of production" means

6 (A) for oil, the value of the oil at the automatic custody transfer
7 meter or device through which the oil enters into the facilities of a carrier
8 pipeline or other transportation carrier in a condition of pipeline quality; in the
9 absence of an automatic custody transfer meter or device, "gross value at the
10 point of production" means the value of the oil at the mechanism or device to
11 measure the quantity of oil that has been approved by the department for that
12 purpose, through which the oil is tendered and accepted in a condition of
13 pipeline quality into the facilities of a carrier pipeline or other transportation
14 carrier or into a field topping plant;

15 (B) for gas, other than gas described in (C) of this paragraph,
16 that is

17 (i) not subjected to or recovered by mechanical
18 separation or gas processing, the value of the gas at the first point
19 where the gas is accurately metered;

20 (ii) subjected to or recovered by mechanical separation
21 but not gas processing, the value of the gas at the first point where the
22 gas is accurately metered after completion of mechanical separation;

23 (iii) subjected to or recovered by gas processing, the
24 value of the gas at the first point where the gas is accurately metered
25 after completion of gas processing;

26 (C) for gas run through an integrated gas processing and gas
27 treatment facility that does not accurately meter the gas after the gas
28 processing and before the gas treatment, the value of the gas at the first point
29 where gas processing is completed or where gas treatment begins, whichever is
30 further upstream;

31 * **Sec. 32.** AS 43.55.900(10) is repealed and reenacted to read:

1 (10) "oil" means

2 (A) crude petroleum oil; and

3 (B) all liquid hydrocarbons that are recovered by mechanical
4 separation of well fluids or by gas processing;

5 * **Sec. 33.** AS 43.55.900 is amended by adding new paragraphs to read:

6 (17) "gas processing"

7 (A) means processing a gaseous mixture of hydrocarbons

8 (i) by means of absorption, adsorption, externally
9 applied refrigeration, artificial compression followed by adiabatic
10 expansion using the Joule-Thomson effect, or another physical process
11 that is not mechanical separation;

12 (ii) for the purpose of extracting and recovering liquid
13 hydrocarbons; and

14 (iii) upstream of any gas treatment and upstream of the
15 inlet of any gas pipeline system transporting gas to a market;

16 (B) does not include gas treatment;

17 (18) "gas treatment"

18 (A) means conditioning gas and removing from gas non-
19 hydrocarbon substances, for the purpose of rendering the gas acceptable for
20 tender and acceptance into a gas pipeline system; and

21 (B) may include incidentally removing liquid hydrocarbons
22 from the gas.

23 * **Sec. 34.** AS 43.55.011(b), 43.55.011(c), 43.55.012(b), 43.55.013(b), 43.55.013(c),
24 43.55.013(d), 43.55.013(g), 43.55.013(h), 43.55.013(i), 43.55.013(j), 43.55.013(k),
25 43.55.016, 43.55.900(1), 43.55.900(8), 43.55.900(11), 43.55.900(12), and 43.55.900(16) are
26 repealed.

27 * **Sec. 35.** The uncodified law of the State of Alaska is amended by adding a new section to
28 read:

29 **APPLICABILITY.** (a) Sections 5, 7 - 10, 12, 13, 15, and 19 - 34 of this Act apply to
30 oil and gas produced on or after July 1, 2006.

31 (b) Section 11 of this Act applies to oil and gas produced before, on, or after the

1 effective date of sec. 11 of this Act.

2 * **Sec. 36.** The uncodified law of the State of Alaska is amended by adding a new section to
3 read:

4 TRANSITION PROVISIONS. (a) Notwithstanding any contrary provision of
5 AS 43.55.024(a), enacted by sec. 12 of this Act, for oil and gas produced on or after July 1,
6 2006, and before January 1, 2007, the phrase "every month an annualized tax credit in an
7 amount equal to one and two-thirds percent" in AS 43.55.024(a), enacted by sec. 12 of this
8 Act, shall be replaced by the phrase "every month during the period July 1, 2006, through
9 December 31, 2006, an annualized tax credit in an amount equal to three and one-third
10 percent."

11 (b) Notwithstanding any contrary provision of AS 43.55.024(e), enacted by sec. 12 of
12 this Act, for oil and gas produced on or after July 1, 2006, and before January 1, 2007, the
13 phrase "a calendar year" in AS 43.55.024(e), enacted by sec. 12 of this Act, shall be replaced
14 by the phrase "the last six months of the calendar year."

15 (c) Notwithstanding any contrary provision of AS 43.55.160(f), enacted by sec. 21 of
16 this Act, for oil and gas produced on or after July 1, 2006, and before January 1, 2007, the
17 phrase "for every month of a calendar year one-twelfth of the producer's adjusted lease
18 expenditures for the calendar year" in AS 43.55.160(f), enacted by sec. 21 of this Act, shall be
19 replaced by the phrase "for each of the last six months of 2006, one-sixth of the producer's
20 adjusted lease expenditures for that six-month period."

21 (d) Notwithstanding any contrary provision of AS 43.55.160(i), enacted by sec. 21 of
22 this Act, for oil and gas produced on or after July 1, 2006, and before January 1, 2007, the
23 number "\$73,000,000" in AS 43.55.160(i), enacted by sec. 21 of this Act, shall be replaced by
24 the number "\$36,500,000."

25 (e) For oil and gas produced before July 1, 2006, the provisions of AS 43.55, and
26 regulations adopted under AS 43.55, that were in effect before July 1, 2006, and that were
27 applicable to the oil and gas continue to apply to that oil and gas.

28 * **Sec. 37.** The uncodified law of the State of Alaska is amended by adding a new section to
29 read:

30 TRANSITION: REGULATIONS. The Department of Revenue may proceed to adopt
31 regulations to implement the changes made by this Act. The regulations take effect under

1 AS 44.62 (Administrative Procedure Act), but not before the effective date of the law
2 implemented by the regulation.

3 * **Sec. 38.** The uncodified law of the State of Alaska is amended by adding a new section to
4 read:

5 REVISOR'S INSTRUCTION. The revisor of statutes is instructed to change the
6 heading of

7 (1) AS 43.55 from "Oil and Gas Production Taxes and Oil Surcharge" to "Oil
8 and Gas Production Tax and Oil Surcharge";

9 (2) article 1 of AS 43.55 from "Oil and Gas Properties Production Taxes" to
10 "Oil and Gas Production Tax";

11 (3) AS 43.55.011 from "Oil production tax" to "Oil and gas production tax";

12 (4) AS 43.55.025 from "Tax credit for oil and gas exploration or gas only
13 exploration" to "Alternative tax credit for oil and gas exploration or gas only exploration";

14 (5) AS 43.55.150 from "Determination of gross value" to "Determination of
15 gross value at the point of production."

16 * **Sec. 39.** Sections 1 - 4, 6, 11, 14, 16, and 37 of this Act take effect immediately under
17 AS 01.10.070(c).

18 * **Sec. 40.** Except as provided in sec. 39 of this Act, this Act takes effect July 1, 2006.